



GOVERNOR'S OFFICE OF  
BUDGET AND PROGRAM PLANNING

## Fiscal Note 2009 Biennium

<b>Bill #</b>	HB0074	<b>Title:</b>	Tax withholding for nonresident mineral, oil, and gas royalty payments
<b>Primary Sponsor:</b>	Campbell, M.	<b>Status:</b>	As Introduced

- |   |   |  |
|---|---|--|
| <input type="checkbox"/> Significant Local Gov Impact     | <input checked="" type="checkbox"/> Needs to be included in HB 2  | <input type="checkbox"/> Technical Concerns              |
| <input type="checkbox"/> Included in the Executive Budget | <input checked="" type="checkbox"/> Significant Long-Term Impacts | <input type="checkbox"/> Dedicated Revenue Form Attached |

### FISCAL SUMMARY

	<u>FY 2008 Difference</u>	<u>FY 2009 Difference</u>	<u>FY 2010 Difference</u>	<u>FY 2011 Difference</u>
<b>Expenditures:</b>				
General Fund	\$443,198	\$128,994	\$128,994	\$128,994
<b>Revenues:</b>				
General Fund (01)	\$2,829,498	\$4,962,479	\$4,962,479	\$4,962,479
<b>Net Impact-General Fund Balance</b>	<u>\$2,386,300</u>	<u>\$4,833,485</u>	<u>\$4,833,485</u>	<u>\$4,833,485</u>

### **Description of Bill:**

Royalties that Montana mineral producers pay to mineral rights owners are Montana source income and are subject to Montana income tax whether the recipient is a resident or non-resident. Under current law, mineral producers are required to report royalty payments of more than \$600 to the IRS, but are not required to report them to Montana or to withhold state income tax. Beginning January 1, 2008, this bill would require mineral producers to withhold income tax from mineral royalty payments to non-resident individuals, trusts, and business entities.

### FISCAL ANALYSIS

#### Assumptions:

- Under current law, owners of Montana mineral interests pay the income tax they owe on mineral royalties only if they choose to file a Montana income tax return and report their royalty income. The Department of Revenue analyzed 2004 payments reported by one of the larger oil and gas producers. Most non-residents and many residents who receive Montana mineral royalties did not file Montana income tax returns. The following table shows that 73.9% of royalties paid to residents were made to residents who reported that income, but only 53.0% of royalties paid to non-residents were reported.

## 2004 Individual Mineral Royalty Recipients Examined by DOR

	<u>% of Royalties</u>	<u>% Who Filed Montana Income Tax Return</u>	<u>% of Royalties Paid to Filers</u>	<u>% of Royalties Paid to Filers Where Recipient Owed Tax</u>	<u>Average 2005 Marginal Tax Rate of Filers who Owed Tax</u>
Residents	19.2%	83.6%	73.9%	92.6%	6.4%
Non-Residents	80.8%	20.6%	53.0%	93.4%	6.5%

- The royalties paid to individuals reported in Assumption 1 were 25.5% of the taxable royalties the company paid in 2004, and 80.8% of those royalties paid to individuals went to non-residents. Thus, non-resident individuals received 20.6% (25.5% x 80.8%) of taxable royalties. This is assumed to hold for all mineral royalties in FY 2008 through FY 2011.
- Non-residents who did not report income to Montana received 47% of royalties paid to non-residents (100% - 53%). The percentage of royalties paid to non-residents who owe tax is assumed to be the same for filers and non-filers. Thus, tax is owed but not paid on 43.9% of royalties paid to non-residents (47% x 93.4%).
- Taxable royalties were 11.8% of gross value reported on oil and gas tax returns for 2001 through 2005.
- The gross value of oil and gas production will be \$2,795,396,000 in FY 2008 and \$2,492,155,000 each year in FY 2009 through FY 2010 (HJR 2).
- Taxable oil and gas royalties paid to non-resident individuals will be \$67,950,486 in FY 2008 (20.6% x 11.8% x \$2,795,396,000) and \$60,579,304 per year in FY 2009 through FY 2011 (20.6% x 11.8% x \$2,492,155,000).
- Non-tribal coal production will be 37,567,700 tons in FY 2008 and 36,411,700 tons per year in FY 2009 through FY 2011 (HJR2 coal severance tax estimate). The market price will be \$10.021523 per ton (HJR2 federal mineral royalties estimate) so that the gross value of production (price times production) will be \$376,485,570 in FY 2008 and \$364,900,689 each year in FY 2009 through FY 2011.
- Royalty rates average 12.5%. Total coal royalties will be \$47,060,696 in FY 2008 (12.5% x \$376,485,570) and \$45,612,586 per year in FY 2009 through FY 2011 (12.5% x \$364,900,689). State and federal coal royalties will be \$36,033,403 in FY 2008 and \$29,610,173 per year in FY 2009 through FY 2010 (HJR2 school trust and federal mineral royalties estimates).
- Taxable coal royalties will be \$11,027,293 in FY 2008 (\$47,060,696 - \$36,033,403) and \$16,002,413 per year in FY 2009 through FY 2010 (\$45,612,586 - \$29,610,173). Taxable coal royalties paid to non-residents will be \$2,271,622 in FY 2008 (20.6% x \$11,027,293) and \$3,296,497 per year in FY 2009 through FY 2011 (20.6% x \$16,002,413).
- The gross value of production from metal mines will be \$1,024,764,685 in FY 2008 and \$880,261,620 per year in FY 2009 through FY 2010. Total metal mine royalties will be \$128,095,586 in FY 2008 (12.5% x \$1,024,764,685) and \$110,032,703 per year in FY 2009 through 2011 (12.5% x \$880,261,620). There are no state or federal metal mine royalties (HJR2 school trust and federal mineral royalties estimates) so that all of these royalties are private.
- Taxable royalties paid to non-residents who owe tax but currently do not report this income (43.9%, see assumption 3) will be \$87,061,468 in FY 2008 (43.9% x (\$67,950,486 + \$2,271,622 + \$128,095,586)) and \$76,345,833 per year in FY 2009 through FY 2011 (43.9% x (\$60,579,304 + \$3,296,497 + \$110,032,703)).
- Non-residents who currently do not report mineral royalty income are assumed to have the same marginal tax rate as nonresidents who do currently report, 6.5%. Tax owed on royalties paid to non-residents who currently do not report will be \$5,658,995 in FY 2008 (6.5% x \$87,061,468) and \$4,962,479 per year in FY 2009 through FY 2011 (6.5% x \$76,345,833).

13. The additional revenue would be deposited in the general fund. Withholding on royalty payments would begin January 2008, or the middle of FY 2008. Withholding on royalty payments for the quarter at the end of the fiscal year are due by July 31, so under current accounting rules these revenues would be accrued to FY 2008. Therefore a half a year's revenue, \$2,829,498, would be deposited in FY 2008, and a full year's revenue, \$4,962,479, would be deposited each following fiscal year.
14. Additional tax will be withheld for out-of-state businesses that do not currently pay Montana taxes. No information exists that can be used to estimate this additional revenue, but the amount is expected to be small relative to revenue from individuals. Thus, no additional revenue is assumed to be generated from businesses.
15. The Department of Revenue would process several hundred additional quarterly withholding returns and 1,000 additional income tax returns each year. The department will create an electronic filing system for quarterly reports and the annual report that will be required of producers. Producers will have the option of using paper forms. The department would require one additional auditor and one support person with total personal services costs of \$103,923 and operating costs of \$327,475 (of which \$302,500 is for software improvements and \$2,500 for forms) in FY 2008 and \$25,071 per year thereafter which includes \$2,853 per year for updating and testing the new form. Initial costs for equipment for these new employees would be \$11,800.

	<b><u>FY 2008 Difference</u></b>	<b><u>FY 2009 Difference</u></b>	<b><u>FY 2010 Difference</u></b>	<b><u>FY 2011 Difference</u></b>
<b><u>Fiscal Impact:</u></b>				
FTE	2.00	2.00	2.00	2.00
<b><u>Expenditures:</u></b>				
Personal Services	\$ 103,923	\$ 103,923	\$ 103,923	\$ 103,923
Operating Expenses	\$ 327,475	\$ 25,071	\$ 25,071	\$ 25,071
Equipment	\$ 11,800	\$ -	\$ -	\$ -
<b>TOTAL Expenditures</b>	<b>\$ 443,198</b>	<b>\$ 128,994</b>	<b>\$ 128,994</b>	<b>\$ 128,994</b>
<b><u>Funding of Expenditures:</u></b>				
General Fund (01)	\$ 443,198	\$ 128,994	\$ 128,994	\$ 128,994
<b>TOTAL Funding of Exp.</b>	<b>\$ 443,198</b>	<b>\$ 128,994</b>	<b>\$ 128,994</b>	<b>\$ 128,994</b>
<b><u>Revenues:</u></b>				
General Fund (01)	\$ 2,829,498	\$ 4,962,479	\$ 4,962,479	\$ 4,962,479
<b><u>Net Impact to Fund Balance (Revenue minus Funding of Expenditures):</u></b>				
General Fund (01)	\$ 2,386,300	\$ 4,833,485	\$ 4,833,485	\$ 4,833,485

**Long-Range Impacts:**

1. The increased revenue will change over time depending on mineral production and prices.

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*Sponsor's Initials*


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*Date*


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*Budget Director's Initials*


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*Date*